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SUSAN LAPSLEY
Director

VIA HAND DELIVERY

June 25, 2007

Ms. Andrea Lynn Hoch
Legal Affairs Secretary
Office of the Governor
State Capitol
Sacramento, California 95814

Re: Request for Review of OAL Decision of Disapproval 07-0427-04SR
Title 18 California Code of Regulations Proposed Section 474
"Petroleum Refining Property"

Dear Ms. Hoch:

Enclosed please find the original response to the above referenced matter, pursuant to Government Code section 11349.5.

If you have any questions, please contact me at 916-323-6808.

Sincerely,

CRAIG TARPENNING

Craig S. Tarpenning
Senior Counsel

Cc: Ramon Hirsig
Executive Director

Robert Lambert
Acting Assistant Chief Counsel

Ms. Diane Olson

Enclosures

STATE OF CALIFORNIA
OFFICE OF ADMINISTRATIVE LAW

In re:	)	RESPONSE TO REQUEST FOR REVIEW OF OAL DECISION OF DISAPPROVAL OF REGULATORY ACTION
BOARD OF EQUALIZATION	)	
	)	(Gov. Code, sec. 11349.5)
REGULATORY ACTION: Title 18, California Code of Regulations	)	OAL File No. 07-0427-04 SR
ADOPT SECTION 474	)	

I. BACKGROUND OF THE REQUEST FOR REVIEW

The Board of Equalization's proposed regulatory action seeks to adopt section 474 to title 18 of the California Code of Regulations. Proposed section 474 defines "petroleum refining property" and establishes a rebuttable presumption, for purposes of recognizing declines in value for such property, that land, improvement, and fixtures and other machinery and equipment classified as improvements constitute one appraisal unit, except when measuring declines in value caused by disaster, in which case the land constitutes a separate appraisal unit.

The proposed regulatory action was originally submitted by the Board of Equalization (Board) to the Office of Administrative Law (OAL) on December 26, 2006. It was subsequently withdrawn by the Board on February 8, 2007 before OAL took any action on the filing. On April 27, 2007, the Board resubmitted the regulatory action to OAL. This resubmission incorporated the prior rulemaking file by reference. The only change in the resubmission from the prior rulemaking file was one minor deletion from the reference citations for section 474. On June 8, 2007, OAL disapproved the above referenced regulatory action because the Initial Statement of Reasons failed to provide the public with the rationale for the determination by the agency that the provisions in section 474 are needed to carry out the purpose for which it is proposed.

On June 18, 2007, the Board of Equalization filed a written request for review with the Governor's Legal Affairs Secretary of this disapproval pursuant to Government Code section 11349.5, subdivision (a) claiming the disapproval should be overruled because: (1) the Board fully complied with all APA requirements; and (2) the intent of the Legislature in creating OAL was that OAL should not substitute its judgment for that of the agency as expressed in the substantive content of proposed regulations.

In this case, OAL has not attempted to in any way substitute its judgment for that of the agency as to the substantive content of the proposed regulations. Rather, OAL has told the Board that they have not fully complied with the rulemaking requirements of the APA for the proposed regulation. Specifically, they must make their explanation for the need for the proposed regulatory provisions available to the public for comment prior to their adoption as a regulation.

II. THE KEY ISSUE FOR REVIEW IS WHETHER A STATE AGENCY MUST MAKE ITS EXPLANATION OF THE NEED FOR PROPOSED REGULATORY PROVISIONS AVAILABLE TO THE PUBLIC FOR COMMENT PRIOR TO THEIR ADOPTION AS A REGULATION.

Government Code section 11349.1(a)(1) requires that OAL review all regulations for compliance with the "necessity" standard. Government Code section 11349(a) defines "necessity" to mean ". . . the record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, taking into account the totality of the record. For purposes of this standard, evidence includes, but is not limited to, facts, studies, and expert opinion."

To further explain the meaning of substantial evidence in the context of the "necessity" standard, subdivision (b) of section 10 of the Title 1 of the California Code of Regulations provides:

> "In order to meet the 'necessity' standard of Government Code section 11349.1, the record of the rulemaking proceeding shall include:
>
> (1) a statement of the specific purpose of each adoption, amendment, or repeal; and
>
> (2) information explaining why each provision of the adopted regulations is required to carry out the described purpose of the provision. Such information shall include, but is not limited to, facts, studies, or expert opinion. When the explanation is based upon policies, conclusions, speculation, or conjecture, the rulemaking record must include, in addition, supporting facts, studies, expert opinion, or other information. An 'expert' within the meaning of this section is a person who possesses special skill or knowledge by reason of study or experience which is relevant to the regulation in question."

In order to provide the public with an opportunity to review and comment upon an agency's perceived need for a regulation, the APA requires that the agency describe the need for the regulation in the Initial Statement of Reasons. Government Code section 11346.2(b) requires that "[a]n initial statement of reasons ***shall*** include...(1) A statement of the specific purpose of each adoption, amendment, or repeal and the ***rationale*** for the determination by the agency that each adoption, amendment, or repeal is ***reasonably necessary to carry out the purpose for which it is proposed***..." (emphasis added).

The Initial Statement of Reasons is not a "brief document" as described by the Board in this appeal, but rather is the primary document in the rulemaking record that demonstrates that the adoption, amendment, or repeal satisfies the "necessity" standard. The Initial Statement of Reasons must include a statement of the specific purpose and the rationale for the determination by the agency that each regulation is reasonably necessary to carry out the purpose for which it is proposed or, simply restated, "why" a regulation is needed and "why" the particular provisions contained in this regulation were chosen to fill that need. (Gov. Code, sec. 11346.2(b)(1).) The Initial Statement of Reasons must also identify any technical, theoretical, or empirical study, report, or similar document upon which the agency relies. (Gov. Code, sec. 11346.2(b)(2).)

The Initial Statement of Reasons must be submitted to OAL with the Notice of the Proposed Action and be made available to the public during the public comment period, along with all the information upon which the proposal is based. (Gov. Code, secs. 11346.2(b) and 11346.5(a)(16) and (b).) In this way the public is informed of why the regulation is needed and why the particular provisions contained in the regulation were chosen to fill that need. This information is essential in order to comment knowledgeably. The Initial Statement of Reasons and all data and other factual information, studies or reports upon which the agency is relying in the regulatory action must also be included in the rulemaking file. (Gov. Code, sec. 11347.3(b)(2) and (7).) The Final Statement of Reasons updates the information contained in the Initial Statement of Reasons and is prepared at the end of the rulemaking process after the public availability and comment periods have concluded. (Gov. Code, sec. 11346.9(a)(1).)

The Initial Statement of Reasons provided with this regulatory action (attached hereto as Exhibit A) does not meet the basic requirement of Government Code section 11346.2. It contains just five short paragraphs: the first paragraph describes in one sentence the general purpose of section 474, the second and third paragraphs briefly describe pertinent provisions in Article XIII of the California Constitution and section 51 of the Revenue and Taxation Code, and the last two paragraphs briefly describe the effect of section 474.

The Board's Initial Statement of Reasons fails to provide the public with the rationale for the determination by the Board as to why the provisions in section 474 are needed to carry out the purpose for which it is proposed, i.e., why the particular provisions contained in the regulation were chosen. For example, for subsection (d)(2) of section 474, there is no information explaining why fixtures and other machinery and equipment classified as improvements on petroleum refining property should be rebuttably presumed to constitute a single appraisal unit with the land and improvements. This is an exception from the assessment practice for most other commercial property.

In this request for review, the Board asserts that the text of proposed regulation section 474 itself provides the missing information. However, proposed regulation section 474 only says that petroleum refining property is "unique" and "...requires the application of specialized appraisal techniques to satisfy the requirements of article XIII...." It does not explain what makes this type of property unique and why this type of property should be assessed in the manner prescribed in order to satisfy the requirements of article XIII. To find this information, one has

to read the first five ***pages*** *and Response 3-1* of the ***Final*** Statement of Reasons for this rulemaking (attached hereto as Exhibit B; see pp. 1-5; and Response 3-1 on p. 8).

It is vital that this information be made available to the public during the rulemaking process so that the public is informed of the basis of the proposed action and can comment knowledgably during the public comment period. In that the 45-day comment period had already been completed, Board staff were advised by OAL in early February, prior to the withdrawal of the original submission of this rulemaking, that this defect in the rulemaking existed and that the defect could be remedied by making the information required to be contained in the Initial Statement of Reasons available to the public for a 15-day written comment period pursuant to sections 11346.8(d) and 11347.1 of the Government Code. The Board could have then made this information available to the public utilizing this quick and easy process and resubmitted the regulation to OAL in short order. Instead, the Board inexplicably elected to withdraw the file from OAL review, wait two and a half months, and resubmit the regulation to OAL without taking any action whatsoever.

This request for review spends some time discussing why further public hearing is not required citing Government Code section 11346.8(c) and urging you to read *Californians for Safe Prescriptions v. California State Board of Pharmacy* (1993), 19 Cal. App. 4th 1136. We also urge you to read this case closely. Although Government Code section 11346.8(c) concerns changes made to the regulation text rather than documents being added to the rulemaking record, the two procedures are nearly identical. In *Californians for Safe Prescriptions*, the Board of Pharmacy made changes to their proposed regulations available to the public pursuant to Government Code section 11346.8(c). Subdivision (c) of Government Code section 11346.8 provides that "...the full text of the resulting adoption, amendment, or repeal, with the change clearly indicated, shall be made available to the public for at least 15 days ***before the agency adopts, amends, or repeals the resulting regulation***...." (emphasis added). The Court upheld this procedure against challenges that the regulations go back out to public hearing. This ruling is absolutely consistent with OAL's action in disapproving the rulemaking action which is the subject of this request for review. In the disapproval decision, OAL did **NOT** advise Board staff that the public hearing on the proposed regulatory action had to be reopened, but rather that the information required to be included in the Initial Statement of Reasons be made available to the public for at least 15 days as required by Government Code sections 11346.8(d) and 11347.

Government Code section 11346.8(d) provides:

> "No state agency shall add any material to the record of the rulemaking proceeding after the close of the public hearing or comment period, unless the agency complies with section 11347.1. This subdivision does not apply to material prepared pursuant to Section 11346.9."

Government Code section 11347.1 requires in subdivisions (b) and (c):

> "(b) At least 15 calendar days ***before the proposed action is adopted*** by the agency, the agency shall mail to all of the following persons a notice identifying the added document

and stating the place and business hours that the document is available for public inspection:
(1) Persons who testified at the public hearing.
(2) Persons who submitted written comments at the public hearing.
(3) Persons whose comments were received by the agency during the public comment period.
(4) Persons who requested notification from the agency of the availability of changes to the text of the proposed regulation.
(c) The document shall be available for public inspection at the location described in the notice for at least 15 calendar days ***before the proposed action is adopted*** by the agency." (Emphasis added.)

In the event any comments are received by the agency on the documents during the 15-day comment period, Government Code section 11346.8(a) requires that the comments be considered by the agency prior to adoption:

"...The state agency shall consider all relevant matter presented to it before adopting, amending, or repealing any regulation."

As such, Government Code sections 11346.8(d) and 11347.1(b) and (c) require that this information be made available to the public and Government Code sections 11347.1(b) and (c) and 11346.8(a) require adoption of the regulation after the public comment periods have concluded. The Board has argued that the last sentence of Government Code section 11346.8(d) allowed the Board to add the information explaining the agency's perceived need for the regulatory provisions to the Final Statement of Reasons without making the information available to the public for at least 15 days prior to adoption as required by Government Code section 11347.1(b) and (c). However, Government Code section 11346.9(a)(1) provides only that the Final Statement of Reasons include an "...***update*** of the information contained in the initial statement of reasons...." (emphasis added). It does not allow an agency to refrain from making the information explaining the agency's perceived need for the particular regulatory provisions available to the public in the Initial Statement of Reasons in favor of simply adding the information to the Final Statement of Reasons after the public comment periods have concluded. To do so, would completely undermine the most basic tenet of the rulemaking process and the APA.

CONCLUSION

A state agency must make its explanation of the need for proposed regulatory provisions available to the public for comment prior to their adoption as regulations. The Board's Initial Statement of Reasons fails to meet the basic requirement of Government Code section 11346.2(b) thereby failing to provide the public with the rationale for the determination by the Board that the provisions in section 474 are needed to carry out the purpose for which it is proposed. For these reasons, the request for review is without merit. OAL respectfully requests that its decision be upheld.

Date: June 25, 2007

CRAIG TARPENNING

CRAIG S. TARPENNING
Senior Staff Counsel

for: SUSAN LAPSLEY
Director

Original: Andrea Lynn Hoch, Legal Affairs Secretary
cc: Ramon Hirsig, Executive Director
Robert Lambert, Acting Assistant Chief Counsel
Diane G. Olson

EXHIBIT A

INITIAL STATEMENT OF REASONS
NON-CONTROLLING SUMMARY

Property Tax Rule 474
Petroleum Refining Properties

Specific Purpose

The purpose of the proposed rule is to implement and make specific the requirements for valuation of real property, personal property, and fixtures used to refine petroleum.

Factual Basis

Section 1 of article XIII of the California Constitution provides that, unless otherwise provided by the California Constitution or the laws of the United States, all property is taxable and all assessed property is taxed in proportion to its full value. Subdivision (b) of section 2 of article XIII A of the California Constitution requires that the base year value of assessed property may not increase annually by more than the inflation factor prescribed in that subdivision.

Section 51 of the Revenue and Taxation Code implements these provisions by establishing methods for adjusting the base year values of assessed real property. Subdivision (d) of section 51 provides that "real property" means "that appraisal unit that person in the marketplace commonly buy and sell as a unit, or that is normally valued separately."

The Board of Equalization proposes to adopt Rule 474 to clarify and make specific certain specialized appraisal techniques for the valuation of real property, personal property, and fixtures used to refine petroleum.

Proposed Rule 474 will (1) define "petroleum refining property;" and (2) establish a rebuttable presumption for purposes of recognizing declines in value that fixtures and machinery and equipment classified as improvements for a petroleum refining property are part of the same appraisal unit as the land and structures. The presumption must be overcome before fixtures are treated as a separate appraisal unit for declines in value, except when measuring declines in value caused by disaster, in which case land constitutes a separate appraisal unit.

EXHIBIT B

FINAL STATEMENT OF REASONS
NON-CONTROLLING SUMMARY

Property Tax Rule 474
Petroleum Refining Properties

Specific Purpose

The purpose of the proposed Property Tax Rule[1] 474 is to clarify and implement the requirements under article XIII, section 1, and article XIII A, section 2, of the California Constitution for the valuation of real property, personal property, and fixtures used to refine petroleum.

Legal and Factual Basis

Based on the rulemaking record, proposed Property Tax Rule (Rule) 474 is well-grounded in law and fact, clarifying and advancing the specific application of the general decline in value rules to petroleum refining properties.

Summary. As explained in more detail below, Rule 461, subdivision (e) provides the general rule that, in appraisals conducted for the purpose of determining whether or not there has been a decline in value in real property upon which improvements, fixtures, and machinery are located, the fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit. This rule is premised upon the normal market situation, applicable to most types of property, where the land and improvements are most commonly sold separately from the fixtures and machinery. Accordingly, when applied to the appraisal of most types of real property, Rule 461, subdivision (e) will result in accurate fair market valuations of both the land and improvements and the fixtures and machinery.

It has long been recognized, however, that Rule 461, subdivision (e) will not produce accurate fair market valuations in all situations. In some exceptional cases involving special types of properties, the normal market situation involves the sale of land, improvements, fixtures and machinery as a single economic unit. In these types of cases, in order to be consistent with the marketplace, the land, improvements, fixtures, and machinery should be valued as a single appraisal unit to determine whether or not there has been a decline in value.

In the past, the Board has adopted regulations for those special types of properties that are not adequately addressed by the general rule set forth in Rule 461, subdivision (e). These types of properties include oil and gas, mining, and geothermal properties, which are governed by Property Tax Rules 468, 469, and 473, respectively. In contrast to present Rule 461, Rules 468, 469, and 473 provide that fixtures and other machinery and equipment classified as improvements do not constitute a separate appraisal unit for

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[1] All references to proposed Property Tax Rule or proposed Rule are to the rule proposed for inclusion in title 18 of the California Code of Regulations.

purposes of determining decline in value. These rules were promulgated in recognition of the unique nature of these properties, and in order to provide the specialized appraisal techniques required to determine their fair market value.

Based upon testimony and evidence submitted to the Board during this rulemaking process, it has been established that petroleum refinery properties also most commonly sell as a single economic unit – including land, improvements, fixtures, and machinery. Thus, as is the case with oil and gas, mining, and geothermal properties, it is inappropriate to apply the "general rule" of Rule 461, subdivision (e) to petroleum refinery properties. In order to address the special characteristics of such properties, Proposed Rule 474 (1) defines the petroleum refining property appraisal unit that normally will be used to determine "full cash value" under article XIII A, section 2; and (2) establishes a rebuttable presumption that fixtures and machinery and equipment classified as improvements, for a petroleum refining property, are part of the same appraisal unit as the land for purposes of recognizing declines in value. This presumption may be overcome by showing that the land and fixtures in a specific petroleum refining property do not operate together as a single economic unit. In the case of declines in value caused by disaster, however, land and fixtures would constitute separate appraisal units. Proposed Rule 474 thereby clarifies how the value of petroleum refining properties should be determined when there has been a decline in value.

Fair market valuation and declines in value. Section 1 of article XIII of the California Constitution states that, unless otherwise provided by the California Constitution or the laws of the United States, all property is taxable and shall be assessed at the same percentage of fair market value. Article XIII A (which contains Proposition 13 as amended by Proposition 8) of the California Constitution requires that all real property be valued at its factored base year value (Proposition 13 value), which is a property's fair market value as of the date of a change in ownership or completion of new construction adjusted annually to reflect an inflation factor of no more than 2 percent, or the property's fair market value at the lien date (Proposition 8 value), whichever is lower. (See Rev. & Tax. Code, § 51, subd. (a).) Proposition 8 amended Proposition 13 to provide a temporary reduction in assessed value where the property has experienced a decline in fair market value to an amount below Proposition 13 value. (*County of Orange v. Renee M Bezaire* (2004) 117 Cal.App.4th 121.)

The determination of whether or not there has been a decline in value of petroleum refining property is currently governed by section[2] 51 and Rule 461, subdivision (e), which provide the general decline in value principles for use in implementing article XIII, section 1 and article XIII A, section 2, of the California Constitution. Under these provisions:

> In determining the extent of a potential decline in value, the assessor must look to the net change in value of the appraisal unit which is commonly bought and sold in the market place, or which is normally valued separately . . . . This means that land and

[2] All section references are to the Revenue and Taxation Code unless otherwise specified.

> improvements are ordinarily treated as a unit, [footnote omitted] and that a taxpayer cannot claim a net decline in full cash value terms of an improvement due to depreciation [i.e. decline in value], without also including any appreciation in the value of the land. If the building depreciation is offset by the increase in land value, then no reduction in assessment occurs. Fixtures, however, are normally appraised separately, thus owners may claim a decline based on depreciation of the fixture without regard to the value of the surrounding land or improvements.[3] (Emphasis added.)

Section 51, subdivision (d) defines an "appraisal unit" alternatively as: (1) that which "persons in the marketplace commonly buy and sell as a unit" or (2) that which is "normally valued separately." The second alternative was adopted in recognition of the fact that fixtures and other machinery and equipment classified as improvements are normally valued separately in the marketplace.

After the passage of Proposition 8, the Board amended Rule 461 to state that fixtures and other machinery and equipment classified as improvements should be treated as a separate appraisal unit. Accordingly, Rule 461, subdivision (e) presently provides that fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit. The Board adopted the language of Rule 461, subdivision (e) on January 25, 1979, and it has remained unchanged since that time. Given such separate appraisal units, no offsetting of land and improvement value vis-à-vis fixture and machinery value can take place, having the effect of isolating fixture and machinery declines in value from land and improvement increases in value. Under such a rule, any fixture and machinery declines in value (from depreciation or any other cause) are immediately recognized for property tax purposes as Proposition 8 value reductions, despite increases in land and improvement value. While this is entirely appropriate and, in fact, mandatory, where the market indicates the existence of two separate appraisal units – one for land and improvements and one for fixtures and machinery – it is inappropriate where the market indicates that, in fact, the two categories of property commonly sell as a single unit.

The appraisal of property at fair market (or full cash) value means the price at which a property, "if exposed for sale in the open market with a reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent under prevailing market conditions between parties who have knowledge of the uses to the property may be put...." (Rule 2, subd. (a) (Emphasis added); see also Rev. & Tax. Code, § 110, subd. (a).) Thus, the price at which property would transfer in the open market is the fundamental principle in defining fair market value. Consequently, for property tax purposes, the unit of property that commonly must be appraised is the one normally dealt with in the market. According to the Board's Assessors' Handbook (AH) 501, *Basic Appraisal*, p. 10-11, "The identification of the property to be appraised is an integral part of the appraisal process. Part of the process of identifying the property is identifying the

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[3] *Implementation of Proposition 13*, Volume 1, *Property Tax Assessment*, Assembly Revenue and Taxation Committee, October 29, 1979, page 13.

'appraisal unit' .... The proper unit to be valued is the unit that people in the market typically buy and sell. For example, single family homes are sold as a combination of land and buildings .... The combination of land and buildings, therefore, comprises the appraisal unit [for single family homes], and the appraisal of this type of property must reflect the value of this unit." Subdivision (b) of Rule 324 similarly provides that, "An appraisal unit of property is a collection of assets that functions together, and that persons in the marketplace commonly buy and sell as a single unit or that is normally valued in the marketplace separately from other property, or that is specifically designated as such by law." (Emphasis added.)

Existing exceptions to Rule 461, subdivision (e). While the general decline in value rule is adequate for properties that can be valued and which sell in the marketplace as separate appraisal units, the Board has adopted special rules for property that, like petroleum refining property, is of a type that is not adequately addressed by the general rule. These types of properties include oil and gas, mining, and geothermal properties, which are governed by Property Tax Rules 468, 469, and 473, respectively. In contrast to present Rule 461, Rules 468, 469, and 473 provide, as an exception to the general rule of decline in value appraisals, that fixtures and other machinery and equipment classified as improvements do not constitute a separate appraisal unit. These rules were promulgated in recognition of the unique nature of these properties, and to provide specialized appraisal techniques required to satisfy the requirements of article XIII, section 1, and article XIII A, section 2, of the California Constitution.

Petroleum refineries. The general decline in value rule set forth in Rule 461, subdivision (e), has been interpreted by some as applying to the valuation of petroleum refinery property. Such application, however, has been criticized as being inconsistent both with market practices and the constitutional requirement of fair market valuation. According to the testimony and evidence presented to the Board, unlike the usual case for most other types of property, in the sale and purchase of petroleum refinery property, land, improvements, and fixtures are commonly bought and sold as a single economic unit; in fact, it appears that the sale of refinery property almost always includes all three categories of property.

Thus, given the testimony and evidence supplied to the Board, application of the "general rule" set forth in Rule 461, subdivision (e) to refinery property is inconsistent with the constitutional requirement of fair market valuation in that such regulatory provision might be interpreted as mandating two separate appraisal units while the petroleum refinery market evidences a single appraisal unit, one that encompasses land and improvements, as well as fixtures and other machinery and equipment classified as improvements. The general rule would be valid for petroleum refinery property only if persons in the marketplace commonly bought and sold refinery land/improvements, on the one hand, and fixtures/machinery, on the other, as separate units; or if such types of property were normally valued separately.[4] But, based upon the market evidence, refinery land, improvements, and fixtures and other machinery and equipment classified

[4] Of course, if two types of property are not bought and sold separately, then generally there is no reason (or basis upon which) to value them separately.

as improvements are commonly bought, sold, and valued as a single unit in the marketplace. Thus, application of the general decline in value rule to petroleum refining property may, under appropriate facts, violate the California Constitution's requirement that property be valued at fair market value. (Cal. Const., art. XIII, § 1 and art. XIII A, § 2.) Proposed Rule 474 corrects this misinterpretation of Rule 461 and section 51.[5]

Proposed Rule 474. Rule 474 is necessary since the current statutory and regulatory scheme does not adequately address the decline in value of petroleum refining property. Similar to properties governed by Rules 468, 469, and 473, petroleum refineries normally would not separately sell their land and fixtures. Written and oral comments received regarding proposed Rule 474 indicate that an operating refinery typically is sold as a single operating unit consisting of the land and improvements and fixtures since all the parts of the refinery must operate together to produce the finished product. Comments also indicate that refineries are different from other heavily-fixturized manufacturing industries in that up to 80 percent of their values are contained in the fixtures, and because the land and fixtures are so integrated, it is difficult to physically separate the fixtures from the land. Further, the land and fixtures are so economically integrated that, in an open market transaction, a buyer would not purchase the land or fixtures separately.

Proposed Rule 474 thus specifically addresses the decline in value appraisal of petroleum refineries. It (1) defines the petroleum refining property appraisal unit that normally will be used to determine "full cash value" under article XIII A, section 2; and (2) establishes a rebuttable presumption that fixtures and machinery and equipment classified as improvements, for a petroleum refining property, are part of the same appraisal unit as the land for purposes of recognizing declines in value. This presumption may be overcome by showing that the land and fixtures in a specific petroleum refining property do not operate together as a single economic unit. In the case of declines in value caused by disaster, however, land and fixtures would constitute separate appraisal units. Proposed Rule 474 thereby clarifies how the value of petroleum refining properties should be determined when there has been a decline in value.

Local Mandate Determination

The State Board of Equalization has determined that proposed Rule 474 does not impose a mandate on local agencies or school districts. Further, the Board has determined that the proposed rule will not result in direct or indirect costs or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code, or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

[5] Note, however, that the proposed rule only provides a presumption that is rebuttable; thus, assessors may make exceptions where appropriate.

Response to Public Comment

The Board received the following written and oral comments on proposed Rule 474. The written comments were received during the 45-day public comment period which ended September 11, 2006. The oral comments were heard at the September 27, 2006 Board meeting. During that meeting, the Board adopted the proposed Rule as published.

Written Comments

Comment 1. Honorable Gus S. Kramer, Assessor, Contra Costa County.

In a letter dated September 12, 2006, Mr. Kramer wrote in support of the adoption of proposed Rule 474, enclosing a letter dated September 1, 2006, written by Dennis Graves, a legal consultant to the Assessor's Office on refinery matters, explaining the legality of proposed Rule 474.

Mr. Graves states that Propositions 8 and 13, as well as section 51, subdivision (d), and Rule 461, subdivision (e) require the valuation methodology set forth in proposed Rule 474. Since these provisions require that the value of property be determined by comparing the property's factored base year value with the property's fair market value for a unit of property for which a fair market value can be determined in a real-world, open-market, non-exigency sale, the only proper appraisal unit for an open-market, non-exigency sale of a refinery is the entire refinery, including land and fixtures. Thus, section 51, subdivision (d) in defining an "appraisal unit" as that which "persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately" may not be read to allow refinery land and fixtures to be valued separately. Instead, it should be read similarly to Rule 324, subdivision (b), which states that an "appraisal unit" is that which "persons in the marketplace commonly buy and sell as a unit, or that is normally valued in the marketplace separately from other property . . . ." By adding the phrase "in the marketplace," Rule 324, subdivision (b) limits the appraisal unit to those units that could actually be sold apart from other property.

In his letter, Mr. Graves also states that "in the case of a viable operating refinery, the entire refinery is invariably sold as a single operating unit consisting of land, buildings, tanks, machinery and equipment necessary to producing gasoline and other finished products." This is because all of the "parts of the plant must operate together to produce the finished product that is to be sold, and the potential buyers are basing their bids on the present value of the income that can be generated over a holding period by producing and selling gasoline using all parts of the plant operating together." Thus potential buyers normally would not be interested in buying any fixtures separate from the land. While there have been some unusual situations where parts of a refinery have been sold, those sales were exigency sales where the plant is usually being shut down for a major renovation.

Thus Rule 461, subdivision (e) is unconstitutional in its application to refineries if it allows refinery fixtures to be valued as a separate appraisal unit from the land because it would violate the Constitutional requirement to tax based on fair market value.

Response

Legal Department staff generally agrees with Mr. Graves' analysis and conclusions.

Comment 2. David R. Doerr, Chair, Task Force on Property Tax Administration of 1978-79.

In a letter dated August 24, 2006, Mr. David Doerr, Chair of the Task Force on Property Tax Administration of 1978-79, wrote in opposition to proposed Rule 474. Mr. Doerr argued that the provisions of proposed Rule 474 are inconsistent with the recommendations of the Task Force on Property Tax Administration and legislation that enacted section 51.

Response

While the intent of section 51 was to separately value and assess fixtures from land, petroleum refineries present a unique industry warranting a unique valuation method as explained in Comment 1 and Response 3-1. Oil and gas producing properties, mining properties, and geothermal properties are also subject to specialized valuation rules because of the extremely high degree of integration of land and fixtures. Further, Mr. Doerr states that the Task Force decided to determine declines in value based on the appraisal unit commonly sold in the marketplace but does not explain the marketplace for refinery properties or describe how they are sold in the marketplace. Finally, Mr. Doerr does not cite any specific provision in the Tax Force recommendations or legislative history of section 51 that addresses the issue of petroleum refinery valuation.

Comment 3. Honorable Bill Leonard, Member, Board of Equalization, Second District.

In a letter dated September 11, 2006, Board Member Bill Leonard objected to the adoption of proposed Rule 474 stating that the proposed rule failed the "six tests" used to evaluate new regulations found in Government Code section 11349.1. His objections and Board staff's responses to those objections follow:

Objection 1: No Necessity

Proposed Rule 474 is unnecessary because no evidence or allegation of underassessment has been presented.

Response 3-1

Sufficient evidence in the rulemaking record exists to determine that proposed Rule 474 is necessary to obtain assessments more accurately reflecting how petroleum refinery properties would actually trade in the marketplace. In addition to Comment 1, at the June 27, 2006 Property Tax Committee meeting, Thomas Parker, Deputy County Counsel, Sacramento County; Rick Auerbach, Los Angeles County Assessor and President of the California Assessor's Association; Lance Howser, Chief Assessor, Solano County; and Robert Quon, Director of Major Appraisals for the Los Angeles County Assessor's office, all testified that refineries are in fact bought, sold, and valued as a single unit. At the same meeting, Mr. Auerbach testified that refineries are different from other heavily-fixturized manufacturing industries such as breweries, canneries, amusement parks and toy manufacturing. Refineries are unique in that up to 80 percent of their values are contained in the fixtures and because the land and fixtures are so integrated, it is difficult to physically separate the fixtures from the land. Further, the land and fixtures are also so economically integrated that a buyer normally would not, in a fair market transaction, purchase the land separately from the fixtures or the fixtures separately from the land.

Since petroleum refineries are bought and sold as a unit consisting of the land and fixtures, to value the fixtures separate and apart from the land may result in assessed values either below or above fair market value in violation of Propositions 8 and 13.

Objection 2: No Authority

The proposed Rule conflicts with the California Constitution, most notably, Proposition 8 and Proposition 13. Thus, the Board of Equalization has no authority to adopt the proposed Rule.

Response 3-2

The Board of Equalization has the authority pursuant to Government Code section 15606 to adopt rules and regulations to interpret, implement and make specific property tax provisions, including Proposition 8, Proposition 13, and section 51. Proposition 8 modified Proposition 13 to allow temporary reductions in assessed values of real property where the Proposition 13 value exceeds the Proposition 8 value. Section 51 was enacted to implement the provisions of Proposition 8.

Objection 3: Lack of Clarity

The proposed Rule is vague and ambiguous. As an example, assessors would be required to determine whether "fixtures and other machinery and equipment classified as improvements are not functionally and physically integrated with the realty and do not

operate together as one economic unit, and that it is not clear how one might define such a unit." Additionally, "it seems hopeless to expect ordinary taxpayers to understand it and apply it" and "it is not clear how one might define such a unit."

Response 3-3

The assessment issues raised by proposed Rule 474 can be clearly understood and determined by assessors and taxpayers, especially those with experience in the oil refining industry. Functional and physical integration are routinely addressed by assessors and taxpayers in the course of valuing property, and are specifically addressed in Rule 122.5, *Fixtures*, and in Chapter 2 of Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures*. Further, "appraisal unit" is defined in subdivision (c) (2) of Rule 122.5 and is addressed in detail in Assessors' Handbook Section 501, *Basic Appraisal*, and Assessors' Handbook Section 502, *Advanced Appraisal*. The determination of the correct "appraisal unit" is also routinely addressed by assessors and taxpayers in the course of valuing property.

Similar assessment issues to those in proposed Rule 474 were addressed by the California Court of Appeal in *Exxon Mobil Corp. v. County of Santa Barbara* (2001) 92 Cal.App.4th 1347. In *Exxon*, the court considered the definitions of "appraisal unit" found in Property Tax Rule 324, subdivision (b) and Assessors' Handbook section 502, *Advanced Appraisal* to determine that an off-shore oil production field and an on-shore refining facility connected only by a single pipeline were part of the same "appraisal unit" for property tax valuation purposes. In reaching that conclusion, the court made factual determinations that the facilities could not stand alone, that the value of the refining facility depended on the value of the production field, that the facilities were in a state of "symbiosis," and that due to the facility development plan and permit restrictions, the refining facility could not be sold separately from the production field. (*Exxon Mobil Corp. v. County of Santa Barbara* (2001) 92 Cal.App.4th 1347, 1353-1354.)

Objection 4: Lack of Consistency

The proposed Rule is inconsistent with section 51, subdivision (d) and Property Tax Rule 461. This inconsistency results in the inconsistent treatment of similarly-situated taxpayers, complicates tax administration, confuses taxpayers and assessors, increases errors and appeals, and creates the impression of favoritism and corruption.

Response 3-4

In the specific case of defining the appraisal unit for purposes of determining declines in value of petroleum refinery properties, proposed Rule 474 interprets, clarifies, and advances Rule 461 and section 51.

Currently, there are no rules specifically governing the declines in value of petroleum refining properties. Rule 461 and section 51 provide a general rule for determination of real property value changes and a general definition of "appraisal unit." Since, as explained in Response 3-1, petroleum refining properties present unique valuation issues related to the definition of the appropriate appraisal unit, Rule 461 and section 51 do not adequately address their valuations. Proposed Rule 474 creates a presumption regarding the appraisal unit to be valued and provides a means to rebut the presumption it creates, both of which are applicable to petroleum refining properties only.

Objection 5: No Reference

Although the proposed Rule contains several statutory references, the text of the rule does not advance. clarify, or interpret those references.

Response 3-5

Proposed Rule 474 furthers the referenced constitutional and statutory authorities by providing specific valuation methods for taxable property that result in appropriate assessed values. Proposed Rule 474 references California Constitution article XIII, section 1 and article XIII A, section 2, as well as sections 51, 53.5, and 110.1. As proposed, Rule 474 creates a rebuttable presumption defining the "appraisal unit" to be used in valuing petroleum refining properties and prescribes a specific methodology by which those properties are valued for all purposes, including declines in value.

Specifically, article XIII, section 1 of the California Constitution requires that all property is taxable. Proposed Rule 474 clarifies how a particular type of property (petroleum refining properties) should be taxed. Article XIII A, section 2 of the California Constitution and section 51 prescribe that taxable property shall be valued at the lesser of fair market value or adjusted base year value. Section 53.5 references an example of a statute allowing the use of a different appraisal method for decline in value purposes than that prescribed in section 51, subdivision (d) and Rule 461, subdivision (e). Proposed Rule 474 defines the petroleum refining property appraisal unit that will be used to determine "full cash value" under article XIII A, section 2, and clarifies how the value of petroleum refining properties should be determined when there has been a decline in value.

Objection 6: Duplication

The proposed Rule serves the same purpose as Property Tax Rule 461, and to the extent that taxpayers could rebut the presumption created by the rule, the tax outcome would be the same as if proposed Rule 474 did not exist.

Response 3-6

Currently, there are no other property tax statutes or rules specifically governing the declines in value of petroleum refining properties. Rule 461 provides a general rule for determination of real property value changes and, in subdivision (e), provides a general definition of "appraisal unit." To the extent that petroleum refining properties present unique valuation issues related to the definition of the appropriate appraisal unit, Rule 461 does not adequately address their valuations.

Proposed Rule 474 creates a presumption regarding the appraisal unit to be valued and provides a means to rebut the presumption it creates, both of which are applicable to petroleum refining properties only. To the extent that including fixtures and other machinery and equipment classified as improvements in the same appraisal unit as land and improvements is inappropriate in valuing a specific petroleum refining property, the taxpayer may submit evidence to overcome the presumption. Thus, in the specific case of defining the appraisal unit for purposes of determining declines in value of petroleum refinery properties, proposed Rule 474 would supersede, not duplicate, Rule 461.

Comment 4. Bob Poole, Coastal Coordinator, Western States Petroleum Association.

In a letter dated September 21, 2006, plus supplemental letters filed on the same day, the Western States Petroleum Association (WSPA) objects to the adoption of proposed Rule 474, stating that the proposed Rule does not comply with the California Administrative Procedures Act and the United States and California Constitutions. WSPA objections, followed by the Board staff's responses, are below:

Objection 1: There is No Necessity for Enactment of Proposed Rule 474, and Proposed Rule 474 is Not Reasonably Necessary to Effectuate Section 51, Subdivision (d)

There is no evidence in the rulemaking record supporting the need for proposed Rule 474. WSPA also states that it is not aware of factual circumstance that justifies changing the way petroleum refineries are currently assessed.

Response 4-1

See Response 3-1.

Objection 2: Proposed Rule 474 is Not Consistent With and Contradicts Various Authorities

Proposed Rule 474 contradicts section 51, Proposition 13, Proposition 8, and Property Tax Rules 461 and 324 since those authorities provide for the presumption that fixtures are not part of the same appraisal unit as land and improvements for purposes of

evaluating declines in value in property while proposed Rule 474 provides the opposite presumption.

Response 4-2

See Response 3-4. Rule 324, subdivision (b) states that an assessor's authority, in assessment appeals, to determine the full value of property is not predicated on nor limited by an applicant's request for relief and the assessor may determine the value of the entire "appraisal unit" when it is necessary to a determination of full value. Thus, determination of the relevant appraisal unit is an essential predicate to the determination of full cash value. In defining an appraisal unit, Rule 324 uses language similar to language in section 51, subdivision (d), which includes in the definition of "appraisal unit" "a collection of assets that function together, and that persons in the marketplace commonly buy and sell as a single unit." Accordingly, given that proposed Rule 474 is not inconsistent with section 51, it also is not inconsistent with Rule 324. Furthermore, Rule 324, subdivision (b), also states that an appraisal unit of property includes collections of assets specifically designated as such by the law. Proposed Rule 474 would make such a designation by creating a rebuttable presumption that petroleum refining properties are a single appraisal unit for decline in value purposes.

Objection 3: The Statutory References Cited in Rule 474 Do Not Support its Enactment

Proposed Rule 474 references sections 51, 53.5 and 110.1. None of these statutes referenced support proposed Rule 474's adoption: section 51 because it contains the opposite presumption as the proposed Rule; section 53.5 because it applies to leach pads, tailing facilities, and settling ponds, none of which are owned by petroleum refineries; and section 110.1 because the term "full cash value" is not used in proposed Rule 474.

Response 4-3

See Response 3-5.

Objection 4: Rule 474 Lacks Clarity

Proposed Rule 474 is unclear because it contains unfamiliar and undefined terms, terms which have more than one meaning, and terms which will be confusing to assessors and taxpayers who are directly affected by the rule. Specifically, WSPA contends that the following terms are unclear:

1. "Unique nature of property used for the refining of petroleum"
2. "Application of specialized appraisal techniques"
3. "'Appraisal unit' consists of the real and personal property that persons in the marketplace commonly buy and sell as a unit."

4. "Petroleum refineries and other real and personal property associated therewith"
5. "Fixtures not ... functionally and physically integrated with the realty."
6. "As identified in Standard Industrial Classification (SIC) System Codes 2911 and 2992, or North American Industry Classification System (NAICS) Codes 32411 and 324191."

Response 4-4

Proposed Rule 474 does not use terms so as to make the Rule unclear and unenforceable as Assessors and directly affected taxpayers currently interpret and apply complex appraisal terms.

1. See Response 3-1.
2. See Response 3-1.
3. See Response 3-1. Proposed Rule 474, subdivision (d)(2) clearly defines the components that make up an "appraisal unit" for petroleum refining purposes as "[t]he land, improvements, and fixtures and other machinery and equipment classified as improvements . . . ." Furthermore, defining an "appraisal unit" is a fundamental duty of assessors and appraisers.
4. The determination of real and personal property associated with petroleum refineries can be made through a development of facts by assessors and taxpayers, especially those that are experienced in the oil refining industry.
5. See Response 3-3.
6. The SIC and the NAICS are coding systems used to classify and measure economic activity by industry categories. The NAICS was developed in 1997 to replace the SIC, which was criticized as outmoded and not reflective of the United States economy. The SIC, however, is still in use by some agencies, most notably the Securities and Exchange Commission. Proposed Rule 474 makes reference to both classification systems. Each of the SIC and NAICS codes referred to in proposed Rule 474 properly identifies industries to which the proposed Rule would apply.[6]

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[6] SIC Code 2911, "Petroleum Refining" is defined as:

> Establishments primarily engaged in producing gasoline, kerosene, distillate fuel oils, residual fuel oils, and lubricants, through fractionation or straight distillation of crude oil, redistillation of unfinished petroleum derivatives, cracking or other processes. Establishments of this industry also produce aliphatic and aromatic chemicals as by-products. Establishments primarily engaged in producing natural gasoline from natural gas are classified in mining industries. Those manufacturing lubricating oils and greases by blending and compounding purchased materials are included in Industry 2992. Establishments primarily re-refining used lubricating oils are classified in Industry 2992. (Occupational Safety and Health Administration, SIC Manual <http://www.osha.gov/pls/imis/sic_manual.display?id=627&tab=description>.)

Objection 5: Proposed Rule 474 Lacks Clarity in the Context of Existing Regulations

The language in Rules 461 and 324 demonstrates that proposed Rule 474 fails to meet the "clarity" standard of Government Code section 11349.1, subdivision (b). The proposed Rule is also inconsistent with Property Tax Rules 468, 469, and 470.

Response 4-5

See Response 3-3. Rule 461 and section 51 govern declines in value for all real property with the exception of oil and gas, mining, and geothermal properties, which are governed by Property Tax Rules 468, 469, and 473, respectively. In contrast to Rule 461, Rules 468, 469, and 473 provide, as an exception to the general rule of decline-in-value appraisal, that fixtures and other machinery and equipment classified as improvements do not constitute a separate appraisal unit. These rules were promulgated in recognition of the unique nature of these properties, and to provide specialized appraisal techniques required to satisfy the requirements of article XIII, section 1, and article XIII A, section 2, of the California Constitution. There is no requirement that special appraisal rules may only be made for depleting asset properties, nor is there any requirement that a property tax rule be "comprehensive" in dealing with all appraisal aspects of a particular industry.

As described in Response 3-1, petroleum refineries would be bought and sold in the marketplace as a single unit because they are heavily-fixturized, with fixtures that are more extensively integrated with the land than other heavily-fixturized manufacturers. Thus, similar to the exception to the general decline in value appraisal method found in Rules 468, 469, and 473, proposed Rule 474 provides an exception for petroleum refineries.

Objection 6: Proposed Rule 474 Violates the "Nonduplication" Standard

The proposed Rule contains provisions which overlap with those set forth in Property Tax Rule 461, subdivision (e).

SIC Code 2992, "Lubricating Oils and Greases," is defined as:

> Establishments primarily engaged in blending, compounding, and re-refining lubricating oils and greases from purchased mineral, animal, and vegetable materials. Petroleum refineries engaged in the production of lubricating oils and greases are classified in Industry 2911. (Occupational Safety and Health Administration, SIC Manual <http://www.osha.gov/pls/imis/sic_manual.display?id=630&tab=description>.)

NAICS Code 32411 refers to the industry group "Petroleum Refineries" which includes the six-digit code 324110 defined in the NAICS Manual as:

> This industry comprises establishments primarily engaged in refining crude petroleum into refined petroleum. Petroleum refining involves one or more of the following activities: (1) fractionation; (2) straight distillation of crude oil; and (3) cracking.

Response 4-6

See Response 3-6.

Objection 7: The Financial Impact of Proposed Rule 474 is Greatly Understated

The cost-impact figure set forth in the Board's August 11, 2006 Notice of Proposed Regulatory Action is too low and the Board should provide the public with the complete basis for its calculation. WSPA states that it believes the cost impact will be at least $5 million, and perhaps as much as $10 million.

Response 4-7

Board staff prepared a Revenue Estimate, Issue # 06-001 (Revenue Estimate), of the impacts of the proposed rule. This is the only dollar-value measure of potential underassessment of petroleum refinery properties that appears in the record to date. As part of the Revenue Estimate, a cost impact of proposed Rule 474 was calculated using WSPA- and County-supplied data. The derivation of this figure is included in the Revenue Estimate. WSPA has not provided data or methodology from which its cost impact estimates can be independently derived.

Objection 8: Proposed Rule 474 Violates Equal Protection Prohibiting Disparate Treatment of Taxpayers

There is no rational basis for proposed Rule 474's disparate treatment of petroleum refineries from other industries with "heavily-fixturized" properties.

Response 4-8

In equal protection challenges to state taxation where no specific federal right apart from equal protection is imperiled, the "States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." (*Amador Valley Joint Union High School District v. State Board of Equalization* (1978) 22 Cal.3d 208, 233-234.) As long as a tax system has a "rational basis" and is not "palpably arbitrary," it will be upheld despite the absence of precise, scientific uniformity of taxation. (*Id.* at 234.) Accordingly, there is a long line of U.S. Supreme Court cases that permit states broad latitude to classify and tax property, including on the basis of: (1) the taxpayer's ability to pay (*Fox v. Standard Oil Company of New Jersey* (1935) 294 U.S. 87, 101); (2) the intangible or tangible nature of the property (*Klein v. Jefferson County Board of Tax Supervisors* (1930) 282 U.S. 19, 23-24); (3) the use of the property (*Clark v. Kansas City* (1900) 176 U.S. 114); (4) the corporate or individual status of the owner (*Lehnhausen v. Lake Shore Auto Parts Co.*

(1973) 410 U.S. 356); or (5) the acquisition date of the property (*Nordlinger v. Hahn* (1992) 505 U.S. 1 (upholding Proposition 13).).

Based on the record, summarized in part in Response 3-1, there is sufficient evidence to determine that a "rational basis" exists for proposed Rule 474, and that it is not "palpably arbitrary."

Objection 9: Proposed Rule 474 Will Produce a Lack of Uniformity in Assessments

A lack of uniformity in assessments will result if proposed Rule 474 is adopted since the proposed Rule will cause petroleum refineries to be assessed differently than other manufacturing and industrial properties, even though there is no palpable distinction between refineries and those other properties.

Response 4-9

Proposed Rule 474 does not violate article XIII, section 1 of the California Constitution which requires that property throughout the state be valued and assessed uniformly. As explained in Response 3-4, specific rules are promulgated for unique industries. As explained in Comment 1 and Response 3-1, evidence exists that petroleum refining properties are unique and qualitatively different from other industrial properties. Accordingly, an exception to the general rule is warranted for petroleum refinery decline in value purposes.

Objection 10: Proposed Rule 474 Violates the Prohibition Against New Property Taxes

The proposed rule effectively imposes a new tax or an increase in taxes on petroleum refineries by making the Proposition 8 protections inapplicable to petroleum refineries.

Response 4-10

Proposed Rule 474 does not violate article XIII A, section 3 of the California Constitution, which states that any changes in State taxes enacted for the purpose of increasing revenues requires a two-thirds legislative approval. The proposed Rule, however, is not being enacted for the purpose of raising revenue. It is being enacted to specify the correct appraisal methodology for a unique industry, where the general appraisal method has been found to be inadequate. Thus, it does not create a new tax, nor does it change the method or rate of tax within the meaning of article XIII A, section 3. It merely sets forth a specific method for the application of Proposition 8 to petroleum refining properties.

Comment 5. Kyla Christoffersen, Legislative Advocate-Taxation, California Chamber of Commerce & Matthew Sutton, Tax Policy Director, California Manufacturers and Technology Association.

In a letter dated September 25, 2006, the California Chamber of Commerce and the California Manufacturers and Technology Association object to the adoption of proposed Rule 474. Those organizations state two objections, summarized below and followed by the Board staff's responses.

Objection 1: The Proposed Rule Would Have Significant Statewide Adverse Economic Impact Since it Sets Precedent to Single Out Particular Industries.

No evidence has been provided in the proposed Rule or throughout the hearing process that refinery fixtures are "unique." Since refinery fixtures simply convert raw petroleum into petroleum suitable for commercial use, there is no distinction between refinery fixtures and fixtures used at other industrial and manufacturing facilities.

Response 5-1

Testimony has been provided that refining fixtures are "unique." See Response 3-1. For economic impact, see Response 4-7.

Objection 2: Proposed Rule 474 Violates Rulemaking Standards Because it Violates the United States and California Constitutions and There is No Statutory Authority or Reference.

The proposed Rule violates constitutional equal protection standards, as well as Propositions 8 and 13, Rule 461, subdivision (e), and section 51, subdivision (d). Thus, there is no authority or reference for the Board of Equalization to adopt proposed Rule 474.

Response 5-2

See Responses 3-2, 3-5, 4-5 and 4-8.

Comment 6. Attorney Cris K. O'Neall of Rodi, Pollock, Pettker, Galbraith & Cahill.

In a letter dated September 25, 2006, Cris O'Neall of the law firm Rodi, Pollock, Pettker, Galbraith & Cahill enclosed a compact disk (CD) containing an audio recording of the June 27, 2006 Board of Equalization Property Tax Committee meeting and requested that the CD to be included in the rulemaking record.

Response

The CD is included as a part of the rulemaking record.

Comment 7. Attorney Cris K. O'Neall of Rodi, Pollock, Pettker, Galbraith & Cahill.

In a letter dated September 26, 2006, Cris O'Neall of the law firm Rodi, Pollock, Pettker, Galbraith & Cahill objects to proposed Rule 474 since Letters to Assessors (LTA) 79/59 and 79/143 affirm that fixtures are separate appraisal units for Proposition 8 purposes.

Response

The above-cited LTAs apply generally to machinery and equipment. To the extent that a new rule such as proposed Rule 474 establishes a different means of calculating declines in value for a specific industry, the cited LTAs would not apply. LTA 79/59 states that the taxable value of machinery and equipment classified as improvements should be the lower of either the factored base year value or the market value, and establishes a new base year value for the machinery or equipment. LTA 79/143 states that LTA 79/59 is incorrect in stating that when the fair market value is lower than the factored base year value a new base year value is established. These LTAs discuss the decline in value rules as they apply generally to fixtures and not specifically to the petroleum refinery industry. Thus, they are of limited value in determining the proper method by which to determine a decline in value of petroleum refinery equipment.

Comment 8. Teresa Casazza, VP-Legislative Director, Cal-Tax.

In a letter dated September 26, 2006, Teresa Casazza stated that Cal-Tax objects to proposed Rule 474 on two grounds. She also offers as an alternative to the adoption of proposed Rule 474, an amendment to Rule 461, subdivision (e).

Objection 1: Violates Government Code 11349.1 "Necessity" Requirement

The Board of Equalization has not demonstrated by substantial evidence the "need for a regulation."

Response 8-1

See Response 3-1.

Objection 2: Violates Government Code 11349.1 "Consistency" Requirement

Proposed Rule 474 conflicts with section 51, subdivision (d)'s presumption that fixtures are a separate appraisal unit by establishing a presumption that fixtures are not presumed to constitute a separate appraisal unit.

Response 8-2

See Response 3-4.

Cal-Tax Alternative: Amendment to Rule 461, Subdivision (e)

The proposed amendment to Rule 461 would create a presumption that fixtures are a separate appraisal unit.

Response 8-3

Rule 461 and section 51, subdivision (d) already presume that fixtures are valued separately for decline in value purposes. However, the amended Rule 461 is inadequate in addressing specific industries, such as the petroleum refining industries, requiring unique valuation methods as described in Comment 1 and Response 3-4. See also Oral Comment 1.

Oral Comments

The following oral comments were made at the September 27, 2006 Board meeting in Sacramento, California.

Comment 1. Rick Auerbach, Assessor, Los Angeles County & President, California Assessors' Association

Mr. Auerbach stated that he supports the adoption of proposed Rule 474. It is consistent with section 51, subdivision (d) since refineries are commonly bought and sold as a unit including the land and structures and fixtures. Mr. Auerbach also stated that homes with fixtures are treated as a single appraisal unit and that if the proposed rule does not pass, it would amount to a break for refineries that is not given to the individual homeowner. Finally, Mr. Auerbach also stated that the Cal-Tax alternative proposal would result in refineries being excluded from appraisal as a single unit since the proposal requires there to be a number of willing buyers and a number of properties for sale at all times.

Response 1

The Board's legal staff generally agrees with Mr. Auerbach's comments.

Comment 2. Gus Kramer, Assessor, Contra Costa County

Mr. Kramer stated that he supports the adoption of proposed Rule 474.

Response 2

None.

Comment 3. Thomas Parker, Deputy County Counsel, Sacramento County

Mr. Parker stated that he supports the adoption of proposed Rule 474.

Response 3

None.

Comment 4. Wayne Lewoczko, ExxonMobil

Mr. Lewoczko stated that there is no difference between oil refineries and other manufacturers. Oil refineries are liquid assembly lines where heat is added to raw materials to create the finished product.

Response 4

See Written Comment 1 and Response 3-1 to the Written Comments above.

Comment 5. Teresa Casazza, California Taxpayers Association

Ms. Casazza expressed two objections: (1) that the enactment of proposed Rule 474 does not meet the consistency and necessity provisions of Government Code section 11342.1; and (2) that the proposed rule conflicts with section 51, subdivision (d). As an alternative, Ms. Casazza submitted a proposed amendment to Rule 461, subdivision (e) creating a presumption that fixtures are a separate appraisal unit for all manufacturers and industries.

Response 5

See Responses 3-1 ,3-4, and 8-3 to the Written Comments above.

Comment 6. Cris O'Neall, Rodi Pollock, representing the Western States Petroleum Association

Mr. O'Neall stated that proposed Rule 474 conflicts with section 51, subdivision (d) and the proposed rule is unnecessary.

Response 6

See Responses 3-1 and 3-4 to the Written Comments above.

Comment 7. Richard Ayoob, Ajalat, Polley & Ayoob

Mr. Ayoob objected to the adoption of proposed Rule 474 because it violates Propositions 8 and 13 without a rational appraisal theory. Other regulations, such as those that deal with the extraction of oil and other minerals, that do not separate fixtures

for decline in value purposes deal with a species of property very different from oil refineries.

Response 7

See Responses 3-2 and 4-8 to the Written Comments above.

Comment 8. Erika Frank, California Chamber of Commerce

Ms. Frank objected to proposed Rule 474 because the proposed rule sets a dangerous precedent of singling out a particular industry, which will add complexity and confusion to the property tax laws.

Response 8

See Responses 3-1 and 4-8 to the Written Comments above.

Comment 9. Matt Sutton, California Manufacturers and Technology Association

Mr. Sutton objected to proposed Rule 474 because the proposed rule sets a dangerous precedent of singling out a particular industry, which may lead to the incremental adoption of similar rules for other industries.

Response 9

See Responses 3-1 and 4-8 to the Written Comments above.

Comment 10. Elizabeth Maeng, ConocoPhillips

Ms. Maeng objected to the adoption of the proposed rule because there is no need to adopt the proposed rule and because adoption of the proposed rule would violate the equal protection clause.

Response 10

See Responses 3-4 and 4-8 to the Written Comments above.

Effect on Business

Pursuant to Government Code section 11346.5, subdivision (a)(8), the Board of Equalization makes an initial determination that the adoption of Rule 474 will not have a significant statewide adverse economic impact directly affecting business because the proposed rule merely interprets and clarifies existing statutory provisions.

The rule will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

The adoption of the rule will not be detrimental to California businesses in competing with businesses in other states.

The rule will not affect small business because the new rule only interprets and clarifies property tax assessment law statutory provisions and does not impose any additional compliance or reporting requirements on taxpayers.

Federal Regulations

Rule 474 has no comparable federal regulation.

Plain English Statement

Rule 474 clarifies the requirements under article XIII, section 1, and article XIII A, section 2, of the California Constitution for the valuation of real property, personal property, and fixtures used to refine petroleum.

Alternatives Considered

The Board has determined that no reasonable alternative considered by it or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed or be as effective as and less burdensome to affected private persons than the proposed action.